

**Letter of Findings: 04-20130656**  
**Sales and/or Use Tax**  
**For the Years 2010, 2011, and 2012**

**NOTICE:** IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective as of its date of publication and remains in effect until the date it is superseded by the publication of another document in the Indiana Register.

**ISSUE**

**I. Sales/Use Tax – Imposition.**

**Authority:** IC § 6-2.5-1-2; IC § 6-2.5-2-1; IC § 6-2.5-3-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-4-1; IC § 6-2.5-5-6; IC § 6-2.5-5-9; IC § 6-8.1-5-1; Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dep't. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Rhoades v. Indiana Dep't of State Revenue, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); USAir, Inc. v. Indiana Dep't of State Revenue, 623 N.E.2d 466 (Ind. Tax Ct. 1993); Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974); Indiana Dep't of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); [45 IAC 2.2-3-4](#); [45 IAC 2.2-5-10](#); [45 IAC 2.2-5-14](#); [45 IAC 2.2-5-16](#).

Taxpayer protests the Department's assessments on additional taxable purchases, claiming that its purchases of labels were exempt from sales/use tax.

**STATEMENT OF FACTS**

Taxpayer is in the business of selling retail and wholesale groceries in Indiana and outside Indiana. In 2013, the Indiana Department of Revenue ("Department") conducted a sales/use tax audit of Taxpayer's business records. Pursuant to the audit, the Department determined that Taxpayer failed to properly collect sales tax on several items sold in its stores. The audit also determined that Taxpayer purchased some tangible personal property to be used during the course of its business without paying sales tax or self-assessing and remitting the use tax.

Taxpayer protested the use tax imposed on its purchases of labels. A phone hearing was held. This Letter of Findings ensues. Additional facts will be provided as necessary.

**I. Sales/Use Tax – Imposition.**

**DISCUSSION**

The Department's audit determined that Taxpayer's purchases of labels were subject to use tax because Taxpayer did not pay sales tax at the time of its purchases. The audit, in relevant part, explains:

[Taxpayer] purchased [blank] labels for their meat, deli, and bakery departments. These labels are printed from the scales in the departments and attached to the packaging outside the product with the barcode, price, weight, and date included on [each of the labels]. These labels are for [Taxpayer's] use to be able to scan the product at check out and therefore they are subject to use tax. These labels do not qualify as wrapping materials, do not become an integral part of the product sold, and do not meet the necessary criteria to be exempt purchases for resale in the same form as they were purchased.

Taxpayer, to the contrary, claimed that its purchases were exempt under IC § 6-2.5-5-6 or IC § 6-2.5-5-9(d).

As a threshold issue, all tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); Indiana Dep't. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012).

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b). Indiana also imposes a complementary excise tax called "the

use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). "Use" means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a). The use tax is functionally equivalent to the sales tax. See *Rhoades v. Indiana Dep't of State Revenue*, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002).

By complementing the sales tax, the use tax ensures that non-exempt retail transactions (particularly out-of-state retail transactions) that escape sales tax liability are nevertheless taxed. *Rhoades*, 774 N.E.2d at 1048; *USAir, Inc. v. Indiana Dep't of State Revenue*, 623 N.E.2d 466, 468 – 69 (Ind. Tax Ct. 1993). The use tax ensures that, after such goods arrive in Indiana, the retail purchasers of the goods bear their fair share of the tax burden. To trigger imposition of Indiana's use tax, tangible personal property must (as a threshold matter) be acquired in a retail transaction. IC § 6-2.5-3-2(a); *USAir, Inc.*, 623 N.E.2d at 468 – 69. A taxable retail transaction occurs when (1) a party acquires tangible personal property as part of its ordinary business for the purpose of reselling the property; (2) that property is then exchanged between parties for consideration; and (3) the property is used in Indiana. See IC § 6-2.5-1-2; IC § 6-2.5-4-1(b) and (c); IC § 6-2.5-3-2(a).

Use of tangible personal property in Indiana could be exempt from Indiana use tax if the sales tax is paid or collected at the time of the purchase pursuant to IC § 6-2.5-3-4 and [45 IAC 2.2-3-4](#). There are also various tax exemptions available outlined in IC § 6-2.5-5. A statute which provides a tax exemption, however, is strictly construed against the taxpayer. *Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Id.* at 101 (internal citations omitted). Thus, in applying any tax exemption, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988).

Claiming that its purchase and use of the blank labels were exempt from sales/use tax, Taxpayer, in this instance, referenced two (2) statutory exemptions, IC § 6-2.5-5-6 and IC § 6-2.5-5-9(d), to support its protest. This Letter of Findings addresses each of them, as follows:

#### **A. Exemption under IC § 6-2.5-5-6.**

Taxpayer claimed that its purchase and use of the labels are exempt from sales and/or use tax pursuant to IC § 6-2.5-5-6.

IC § 6-2.5-5-6, in relevant part, states:

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for **incorporation as a material part of other tangible personal property which the purchaser manufactures, assembles, refines, or processes for sale in his business.**

**(Emphasis added).**

[45 IAC 2.2-5-14](#) further explains:

- (a) The state gross retail tax shall not apply to sales of any tangible personal property which is to be incorporated by the purchaser as a material or an integral part into tangible personal property produced for sale by such purchaser in the business of manufacturing, assembling, refining or processing.
- (b) The exemption provided by this regulation [\[45 IAC 2.2\]](#) applies only to tangible personal property to be incorporated as a material or an integral part into tangible personal property produced for sale by a purchaser engaged in the business of manufacturing, assembling, refining or processing. This regulation [\[45 IAC 2.2\]](#) does not apply to persons engaged in producing tangible personal property for their own use.
- (c) This regulation [\[45 IAC 2.2\]](#) does not exempt from tax tangible personal property to be used in production, such as supplies, parts, fuel, machinery, etc., refer to Regs. 6-2.5-5-5(010) and 6-2.5-5-5(020) (dealing with material consumed in direct production) for the application of those regulations to taxpayers engaged in the production of tangible personal property.
- (d) The purchase of tangible personal property which is to be incorporated by the purchaser as a material or an integral part is exempt from tax. "Incorporated as a material or an integral part into tangible personal property for sale by such purchaser" means:**
  - (1) That the material must be physically incorporated into and become a component of the finished product;**

- (2) The material must constitute a material or an integral part of the finished product; and
- (3) The tangible personal property must be produced for sale by the purchaser.

(e) Application of general rule.

- (1) Incorporation into the finished product. The material must be physically incorporated into and become a component part of the finished product.
- (2) Integral or material part. The material must constitute a material or integral part of the finished product.
- (3) The finished product must be produced for sale by the purchaser.

(Emphasis added).

[45 IAC 2.2-5-10](#), in relevant part, provides:

(a) In general, **all purchases of tangible personal property by persons engaged in the processing or refining of tangible personal property are taxable.** The exemption provided in this regulation [[45 IAC 2.2](#)] extends only to manufacturing machinery, tools, and equipment used in direct production. It does not apply to materials consumed in production or to materials incorporated into the tangible personal property produced. Additionally, the exemption provided in this regulation [[45 IAC 2.2](#)] extends to industrial processors. An industrial processor, as defined in [IC 6-2.5-4-2](#), is one who:

- (1) acquires tangible personal property owned by another person;
- (2) provides industrial processing or servicing, including enameling or plating, on the property; and
- (3) transfers the property back to the owner to be sold by that owner either in the same form or as a part of other tangible personal property produced by that owner in his business of manufacturing, assembling, constructing, refining, or processing.

...

(k) Definitions. Processing or refining is defined as the performance by a business of **an integrated series of operations which places tangible personal property in a form, composition, or character different from that in which it was acquired. The change in form, composition, or character must be a substantial change.** Operations such as distilling, brewing, pasteurizing, electroplating, galvanizing, anodizing, impregnating, cooking, heat treating, and slaughtering of animals for meal or meal products are illustrative of the types of operations which constitute processing or refining, although any operation which has such a result may be processing or refining. A processed or refined end product, however, must be substantially different from the component materials used.

(Emphasis added).

In this instance, Taxpayer claimed that its purchase and use of the blank labels were exempt from sales/use tax under IC § 6-2.5-5-6. Taxpayer stated, in relevant part, that:

Example of how this applies to [Taxpayer] is as follows:

A Whole Pork Loin is purchased, a Butcher will remove this item from its original packaging and they will process it by Trimming, Cutting, Tenderizing, and/or Seasoning it. They proceed to package the processed items into non-returnable containers, wrap, weigh and Label the items for re-sale.

Taxpayer thus maintained, "The labels qualify for the exemption because they become a part of the Final Product that has been processed in our store." To support its protest, Taxpayer further provided sample labels illustrating its use of the labels.

Upon reviewing Taxpayer's supporting documentation, however, the Department is not able to agree that Taxpayer's purchase and use of labels are exempt pursuant to the above mentioned statutes and regulations. First, Taxpayer claimed that it is in the business of processing tangible personal property because its employees, namely butchers, trim, cut, tenderize, and/or season the meat. However, to be in the business of processing, Taxpayer must demonstrate that its operation "places tangible personal property in a form, composition, or character different from that in which it was acquired. The change in form, composition, or character must be a substantial change." [45 IAC 2.2-5-10\(k\)](#). "Trimming, [c]utting, [t]enderizing, and/or [s]easoning" do not result in a substantial change of the tangible personal property sold at Taxpayer's grocery stores.

Additionally, even if, for the sake of argument, that Taxpayer is in the business of processing, Taxpayer's purchase and use of the labels at issue did not qualify for the exemption under IC § 6-2.5-5-6 and [45 IAC 2.2-5-14](#). Each of Taxpayer's sample labels contained (1) Seller's Name, (2) a bar code, (3) name of the tangible

personal property, i.e., name of the "Finished Product," (4) a "sell by" date, (5) net weight, (6) unit price, (7) total sale price, (8) a set of "Safe Handling Instructions," and (9) "Product of USA." In Example provided by Taxpayer, "They proceed to package the processed items into non-returnable containers, wrap, weigh and Label the Items for re-sale." Thus, Taxpayer's Example demonstrates that its process ended at the time the trimmed, cut, tenderized and/or seasoned tangible personal property was produced. Thus, Taxpayer used the labels after the processed tangible personal property, i.e., Pork Loin, was already placed into containers, wrapped with wrapping materials, and weighed. That is, the labels at issue were not physically incorporated as material parts or integral parts of the processed tangible personal property and did not become a component part of the finished product, namely Taxpayer's Pork Loin, for which Taxpayer sold at its grocery stores. Taxpayer's customers who purchase the processed Pork Loin at the Taxpayer's store intend to buy and cook the Pork Loin, not the labels, and the labels do not become material parts or integral parts of the processed Pork Loin. Rather, the labels at issue were adhered to the wrapping materials, which were used to package the processed tangible personal property at Taxpayer's store. Thus, the Department is not able to agree that the labels would become part of the product.

In short, Taxpayer's purchase and use of the labels were not exempt under IC § 6-2.5-5-6 and [45 IAC 2.2-5-14](#).

**B. Exemption under IC § 6-2.5-5-9(d).**

Alternatively, Taxpayer claimed that its purchase and use of the labels were exempt under IC § 6-2.5-5-9(d).

IC § 6-2.5-5-9(d) states:

Sales of wrapping material and empty containers are exempt from the state gross retail tax if the person acquiring the material or containers acquires them for use as nonreturnable packages for:

- (1) selling the contents that the person adds; or
- (2) shipping or delivering tangible personal property that:
  - (A) is owned by another person;
  - (B) is processed or serviced for the owner; and
  - (C) will be sold by that owner either in the same form or as a part of other tangible personal property produced by that owner in the owner's business of manufacturing, assembling, constructing, refining, or processing.

[45 IAC 2.2-5-16](#) further explains:

- (a) The state gross retail tax shall not apply to sales of nonreturnable wrapping materials and empty containers to be used by the purchaser as enclosures or containers for selling contents to be added, and returnable containers containing contents sold in a sale constituting selling at retail and returnable containers sold empty for refilling.
- (b) In general the gross proceeds from the sale of tangible personal property in a transaction of a retail merchant constituting selling at retail are taxable. This regulation [\[45 IAC 2.2\]](#) provided an exemption for wrapping materials and containers.
- (c) General rule. The receipt from a sale by a retail merchant of the following types of tangible personal property are exempt from state gross retail tax:
  - (1) Nonreturnable containers and wrapping materials including steel strap and shipping pallets to be used by the purchaser as enclosures for selling tangible personal property.
  - (2) Deposits for returnable containers received as an incident to a transaction of a retail merchant constituting selling at retail.
  - (3) Returnable containers sold empty for refilling.
- (d) Application of general rule.
  - (1) Nonreturnable wrapping material and empty containers. To qualify for this exemption, nonreturnable wrapping materials and empty containers must be used by the purchaser in the following way:
    - (A) The purchaser must add contents to the containers purchased; and
    - (B) The purchaser must sell the contents added.
  - (2) Returnable containers sold at retail with contents. To qualify for this exemption, the returnable containers must be:
    - (A) Sold in a taxable transaction of a retail merchant constituting selling at retail; and
    - (B) Billed as a separate charge by the retail merchant to his customer. If there is a separate charge for such containers, the sale of the container is exempt from tax under this regulation [\[45 IAC 2.2\]](#).
  - (3) Returnable containers sold empty. To qualify for this exemption the returnable container must be resold with the purpose of refilling. The sale of returnable containers to the original or first user thereof is taxable.
- (e) Definitions.

- (1) Returnable containers. As used in this regulation [\[45 IAC 2.2\]](#), the term returnable container means containers customarily returned by the buyer of the contents for reuse as containers.
- (2) Nonreturnable containers. As used in this regulation [\[45 IAC 2.2\]](#), the term "nonreturnable containers" means all containers which are not returnable containers.

In this instance, Taxpayer claimed that its purchase and use of the labels were exempt under IC § 6-2.5-5-9(d). Taxpayer stated, in relevant part, that:

The Labels in question are purchased solely for the purpose of becoming a part of the Non-returnable packaging of Food items that are prepared and resold in the Meat, Deli and Bakery Departments.

Upon reviewing Taxpayer's documentation, however, the Department is not able to agree that Taxpayer's purchase and use of the blank labels were exempt pursuant to IC § 6-2.5-5-9(d). First, Taxpayer claimed that it is in the business of processing tangible personal property because its employees, namely butchers, trim, cut, tenderize, and/or season the meat. However, to be in the business of processing, Taxpayer must demonstrate that its operation "places tangible personal property in a form, composition, or character different from that in which it was acquired. The change in form, composition, or character must be a substantial change." [45 IAC 2.2-5-10\(k\)](#). "Trimming, [c]utting, [t]enderizing, and/or [s]easoning" do not result in a substantial change of the tangible personal property sold at Taxpayer's grocery stores.

Additionally, even if, for the sake of argument, that Taxpayer is in the business of processing, Taxpayer's purchase and use of the labels at issue did not qualify for the exemption under IC § 6-2.5-5-9 and [45 IAC 2.2-5-16](#). Taxpayer claimed that the labels at issue were "solely for the purpose of becoming a part of the Non-returnable packaging of Food items that are prepared and resold in the Meat, Deli and Bakery Departments." However, as discussed earlier, Taxpayer's employees, after trimming, cutting, tenderizing, and seasoning the tangible personal property, proceeded to package "the processed items into non-returnable containers, wrap, weigh and Label the items for re-sale." Although Taxpayer intended to use the labels solely on packaged items for resale, the labels at issue were not used to contain or wrap the items for resale. Rather, the labels were affixed to the wrapping materials to identify the items being sold at Taxpayer's grocery store. Or, as the audit noted, "The labels are primarily used by [Taxpayer] to scan the product at checkout." Thus, Taxpayer's purchase and use of the labels were not used as wrapping materials or non-returnable containers. Therefore, Taxpayer's purchase and use of the labels were not exempt under IC § 6-2.5-5-9(d) and [45 IAC 2.2-5-16](#).

Thus, given the totality of the circumstances, in the absence of other supporting documentation, the Department is not able to agree that Taxpayer met its burden of proof to demonstrate that its purchase and use of the labels at issue were exempt pursuant to the above mentioned statutes and regulations. Since Taxpayer did not pay sales tax at the time of its purchases, use tax is properly imposed.

### FINDING

Taxpayer's protest is respectfully denied.

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